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NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIFTH APPELLATE DISTRICT

U.S. BANK NATIONAL ASSOCIATION, Plaintiff and Appellant, v. BARRY LAMÉ, Defendant and Respondent.	F056380 (Super. Ct. No. CU151419) **OPINION**

APPEAL from a judgment of the Superior Court of Merced County. Ronald W. Hansen, Judge.

Bardellini, Straw, Cavin & Bupp, John F. Cavin, Helen V. Powers and Steven J. Kahn, for Plaintiff and Appellant.

Barry Lamé, in pro. per., for Defendant and Respondent.

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This is an appeal from the denial of plaintiff's request for a preliminary injunction, by which plaintiff sought to enjoin defendant from executing on certain real property against which defendant has a judgment lien. Plaintiff claims it is subrogated to the interests of prior lien holders and encumbrancers whose interests in the property predated defendant's judgment lien, and therefore plaintiff's interest takes priority. Plaintiff contends it will suffer irreparable injury through the loss of its security if defendant is permitted to sell the property at an execution sale. We conclude the trial court misinterpreted and misapplied the law of equitable subrogation and therefore reverse.

FACTUAL AND PROCEDURAL BACKGROUND

The first amended complaint[1] alleges the following facts. On February 15, 2007, the bankruptcy court entered a nondischargeable judgment for approximately $92,000 in favor of defendant Barry Lamé and against George Jercich[2]; defendant recorded the judgment in Merced County on March 27, 2007. In March 2007, the predecessor of plaintiff, U.S. Bank National Association, agreed to loan Jercich $504,000. The loan was secured by a deed of trust against Jercich's real property, which was dated March 23, 2007, and recorded on April 4, 2007. The loan was used to repay existing liens and encumbrances on the property in excess of $400,000. Jercich knew of defendant's judgment, but failed to disclose it to plaintiff's predecessor, and plaintiff and its predecessor were ignorant of defendant's lien claim. Defendant attempted to execute on his judgment against Jercich's real property.

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1 A second amended complaint was filed on December 1, 2008, and the record on appeal was augmented to include that pleading. The pleading in effect at the time the preliminary injunction was denied, however, was the verified first amended complaint. The first amended complaint, along with a request for judicial notice, provided the factual basis on which the request for a preliminary injunction was based, since no declarations were filed.

2 George Jercich was originally a named defendant in this case; he was dismissed on August 28, 2008.

Plaintiff filed its complaint, seeking equitable subrogation, declaratory relief, and an injunction to prevent defendant from executing on the property. On July 28, 2008, the court denied plaintiff's ex parte application for a temporary restraining order, but issued an order to show cause why a preliminary injunction should not be entered. Defendant filed opposition, and the preliminary injunction was denied on August 27, 2008. Plaintiff timely filed its notice of appeal.

Plaintiff contends the trial court misapplied the law of equitable subrogation and abused its discretion when it denied plaintiff's request for a preliminary injunction. Plaintiff claims its interest in Jercich's property is prior to defendant's, because it satisfied Jercich's obligations at Jercich's request and is equitably subrogated to the interests of the prior lien holders, whose interests predated defendant's judgment lien. The trial court concluded plaintiff was not likely to prevail on its claim of equitable subrogation, apparently because it concluded plaintiff had no interest in the property to protect at the time it paid off the obligations underlying Jercich's existing liens, and therefore plaintiff made the payments as a volunteer.

DISCUSSION

I. Standard of Review

The granting or denial of a preliminary injunction rests in the sound discretion of the trial court and must be based on a consideration of all the circumstances of the particular case. (*Salazar v. Eastin* (1995) 9 Cal.4th 836, 850.) The trial court's decision will not be reversed on appeal except for an abuse of discretion. (*Ibid*.) A decision that rests on an error of law constitutes an abuse of discretion. (*In re Esperanza C.* (2008) 165 Cal.App.4th 1042, 1061.)

Where no issue of fact is presented, the question is one of law, which is reviewed de novo. (*California Correctional Peace Officers Assn. v. State of California* (2000) 82 Cal.App.4th 294, 302; *Oxford v. Foster Wheeler LLC* (2009) 177 Cal.App.4th 700, 707.) Additionally, where the trial court's ruling is based on assertedly improper criteria or

incorrect legal assumptions, it is subject to de novo review. (*Cho v. Seagate Technology Holdings, Inc*. (2009) 177 Cal.App.4th 734, 745.) Here, the material facts presented in the request for preliminary injunction are undisputed and, to the extent plaintiff contends the trial court misinterpreted or misapplied the applicable law, review is de novo.

II. Preliminary Injunction

In determining whether to grant or deny a preliminary injunction, the trial court evaluates two factors: (1) the likelihood that plaintiff will prevail on the merits at trial and (2) the interim harm that plaintiff is likely to sustain if the injunction is denied as compared to the harm the defendant is likely to suffer if the injunction is issued. (*Cohen v. Board of Supervisors* (1985) 40 Cal.3d 277, 286.) In its request for a preliminary injunction, plaintiff argued that it was equitably subrogated to the position of the prior lienors and encumbrancers after it paid off the obligations underlying those liens and encumbrances with the monies loaned to Jercich. It contended it would be irreparably harmed if defendant was permitted to execute on the property, because plaintiff would lose its security interest in the property and would have no opportunity to establish its claim to priority. It asserted defendant would not be harmed if the injunction were granted, because the injunction would maintain the status quo while the issue of priority was litigated.

Defendant opposed plaintiff's request for a preliminary injunction, arguing plaintiff had no chance of prevailing in the action; he asserted plaintiff's interest in the property was junior to defendant's, because plaintiff's deed of trust was recorded after defendant's judgment. In his respondent's brief, defendant again argues that his interest in the property is senior to plaintiff's, and he adds an argument that plaintiff does not meet the requirements for application of the doctrine of equitable subrogation.

At the hearing of the request for preliminary injunction, the trial court expressed its opinion that plaintiff acted as a volunteer in paying off the liens and encumbrances on the property, because plaintiff had no existing interest to protect by doing so and it

voluntarily refinanced Jercich's debts; the court concluded the doctrine of equitable subrogation did not apply. In its order denying the preliminary injunction, the trial court found that plaintiff would not prevail on its claims because it was not entitled to be equitably subrogated to a priority position senior to that of defendant by virtue of its payment of pre-existing liens and encumbrances against the property. Thus, the issue presented by this appeal is whether the trial court made an error of law when it determined that, under the doctrine of equitable subrogation, a lender that refinances a loan at the request of the debtor and uses all or a portion of the funds loaned to remove existing liens and encumbrances from the property is a volunteer to whom equitable subrogation is denied.

III. Equitable Subrogation

Generally, the priority of liens on real property is determined by the principle of "'first in time, first in right'"; liens that are recorded first have priority over any later-recorded liens, all other things being equal. (*DMC, Inc. v. Downey Savings & Loan Assn.* (2002) 99 Cal.App.4th 190, 195-196.) Defendant's judgment was recorded prior to plaintiff's deed of trust, so defendant claims priority.

Under some circumstances, however, a lien holder may acquire an earlier priority when the lien holder pays an indebtedness secured by an earlier lien and becomes equitably subrogated to the rights of the earlier lien holder. Five prerequisites to equitable subrogation have been identified: "'(1) Payment must have been made by the subrogee to protect his own interest. (2) The subrogee must not have acted as a volunteer. (3) The debt paid must be one for which the subrogee was not primarily liable. (4) The entire debt must have been paid. (5) Subrogation must not work any injustice to the rights of others.'" (*Caito v. United California Bank* (1978) 20 Cal.3d 694, 704 (*Caito*).) As the *Caito* court also noted, however, "'As now applied [the doctrine of equitable subrogation] is broad enough to include every instance in which one person, not acting as a mere volunteer or intruder, pays a debt for which another is primarily liable,

and which in equity and good conscience should have been discharged by the latter.'" (*Ibid*.)

In *Simon Newman Co. v. Fink* (1928) 206 Cal. 143 (*Simon Newman*), defendant Medlin executed a mortgage on certain personal property to defendant First National Bank to secure payment of two promissory notes. He subsequently executed another mortgage of the same property to Fink, an officer of the bank. Medlin later arranged a loan with plaintiff; plaintiff was to pay off the notes secured by the mortgage to the bank and receive a new mortgage on the same property. Plaintiff paid the debts to the bank, recorded a release of the old mortgage, and recorded its own new mortgage. Defendants contended plaintiff was not entitled to revive the original mortgage and be subrogated to the rights of the bank, because plaintiff was a mere volunteer. (*Id*. at p. 145.)

The court quoted the general rule applicable to those who advance money to pay off encumbrances: "'One who advances money to pay off an encumbrance on realty at the instance of either the owner of the property or the holder of the incumbrance, either on the express understanding, or under circumstances from which an understanding will be implied, that the advance made is to be secured by a first lien on the property, is not a mere volunteer; and in the event the new security is for any reason not a first lien on the property, the holder of such security, if not chargeable with culpable and inexcusable neglect, will be subrogated to the rights of the prior encumbrancer under the security held by him, unless the superior or equal equities of others would be prejudiced thereby, and to this end equity will set aside a cancellation of such security, and revive the same for his benefit.'" (*Simon Newman, supra*, 206 Cal. at p. 146.) The court also noted a seemingly contrary rule cited by defendants: "'One who advances money to pay the debt of another, in the absence of agreement, express or implied, for subrogation, will not be entitled to succeed to the rights and remedies of the creditor so paid unless there is some obligation, interest, or right, legal or equitable, on the part of such person in respect of the

matter concerning which the advance is made, as otherwise he is a stranger, a volunteer, an intermeddler, to whom the equitable right of subrogation is never accorded.'" (*Ibid*.)

The court concluded the statements did not conflict. "There is no conflict in these two statements, and no quarrel with the correctness of either of them. What the appellants have failed to appreciate is that one who pays off an encumbrance at the request either of the mortgagor or of the holder of the encumbrance with the understanding that he is to have a first lien as security is not a volunteer." (*Simon Newman, supra,* at pp. 146-147.) The court affirmed the judgment in favor of plaintiff, reviving and foreclosing the first mortgage on the property. (*Id*. at pp. 144, 148.)

In *Katsivalis v. Serrano Reconveyance Co*. (1977) 70 Cal.App.3d 200 (*Katsivalis*), plaintiff's husband refinanced loans on real property belonging to him and plaintiff on which a homestead had been declared. The homestead was recorded after first and second deeds of trust. As a result of the refinancing, the property was subjected to a new first deed of trust, replacing the two original deeds of trust. The issue was whether the new first trust deed of trust was subject to the prior declaration of homestead. The trial court granted the lender equitable relief, finding it was subrogated to the rights of the original lienors. Citing *Simon Newman*, the court approved that relief. (*Katsivalis,* at p. 210.) It rejected plaintiff's argument that the relief granted violated the policy of the homestead law. "[T]he reinstatement of the prior encumbrance does not involve a curb on the homestead, but merely prevents unjust enrichment and restores it to its original worth. No new rights are created in the creditor, and the policy of the homestead law is not subverted." (*Id*. at p. 213.) The court remanded the matter to the trial court to determine the amount of the lien to which the lender was subrogated based on the liens it discharged. (*Id*. at p. 215.)

In *Smith v. State Savings & Loan Assn*. (1985) 175 Cal.App.3d 1092 (*Smith*), F&D Properties owned a condominium complex subject to three encumbrances. Plaintiff Smith sold property to F&D and received notes and deeds of trust secured by the

condominium property, which he recorded fourth in priority. Subsequently, defendant State Savings and Loan (State) provided new financing for the condominium complex, with the understanding that its refinancing would be secured by a first deed of trust on the condominium property. State had no actual knowledge of Smith's encumbrances, but it had constructive knowledge because they had been recorded. State contended its deed of trust had priority over Smith's, because State was subrogated to the rights of the three former encumbrancers to the extent of their encumbrances. (*Id.* at p. 1096.)

The trial court denied equitable subrogation, because "(1) the new loans provided by State did not comply with terms under which Smith had expressly agreed his trust deeds could be subordinated; (2) State had constructive knowledge of Smith's trust deeds because they had been recorded; and (3) State had no prior 'interest to protect in making the loans.'" (*Smith, supra*, 175 Cal.App.3d at p. 1096.) The court reversed. It quoted the same rule cited in *Katsivalis* and *Simon Newman*: """"'One who advances money to pay off an encumbrance on realty at the instance of either the owner of the property or the holder of the incumbrance, either on the express understanding, or under circumstances from which an understanding will be implied, that the advance made is to be secured by a first lien on the property, is not a mere volunteer; and in the event the new security is for any reason not a first lien on the property, the holder of such security, if not chargeable with culpable and inexcusable neglect, will be subrogated to the rights of the prior encumbrancer under the security held by him .'""" (*Smith*, at p. 1096.)

The court concluded the terms under which Smith agreed to subordination were not dispositive. "[Smith] knowingly and willingly accepted a fourth priority position, junior to three existing encumbrances. State here seeks only to be subrogated to the rights of the three prior encumbrances and only to the extent of those encumbrances. [Citation.] The whole theory of equitable subrogation in such situations is that the junior encumbrancer (Smith) is left in exactly the same junior position he had before. [Citations.] If granting equitable subrogation to State would not prejudice Smith but

leave him in the same position he had before, and is otherwise equitable, it should be granted. Application of the doctrine in no way depends upon meeting conditions laid down by Smith under which he would expressly subordinate his interests." (*Smith, supra*, 175 Cal.App.3d at pp. 1097-1098.)

The court rejected the trial court's conclusion that State's failure to discover Smith's recorded trust deeds constituted the type of "'culpable and inexcusable neglect'" which would justify denial of equitable subrogation. "Although equitable subrogation will be denied to a new lender who has actual knowledge of the junior encumbrance, it has long been the rule in California that the fact the junior encumbrance was recorded will not by itself bar equitable subrogation." (*Smith, supra*, 175 Cal.App.3d at p. 1098.)

The court also rejected the trial court's conclusion that equitable subrogation did not apply because State had no preexisting interest to protect by making the loan to F&D and was therefore a mere volunteer. The court distinguished *Caito* and its recitation of the elements of equitable subrogation. (*Smith, supra*, 175 Cal.App.3d at 1098.) It noted that the issue in *Caito* was not whether the subrogee acted as a volunteer, but whether a purported subrogee could be subrogated to the rights of the creditor where the subrogee was primarily liable on the debt. The court concluded: "State provided refinancing at the request of the debtor, F & D. Unaware of Smith's interest, State paid off the senior encumbrances in order to secure State's new loan with a first trust deed. In making such a loan in the course of its business, State obviously had sufficient interest to entitle it to subrogation to the rights of the senior encumbrances. One who advances money at the request of the debtor to pay off an encumbrance with the understanding that the advance will be secured by a first trust deed '"'…is not a mere volunteer.'"' [Citations.]" (*Smith*, at p. 1099.)

These cases illustrate that the doctrine of equitable subrogation may apply to a lender that refinances existing obligations secured by deeds of trust on real property, even though the lender lacks a pre-existing interest in the property; the refinancing lender, who

acted at the request of the debtor, is not a mere volunteer. The lender may be equitably subrogated to the interests of the prior lien holders whose deeds of trust have been satisfied and released through the refinancing, and the new lender's interest may take priority over the interest of an intervening junior lien holder.

Plaintiff presented sufficient evidence to establish the likelihood it will prevail on the merits of its equitable subrogation claim at trial. Defendant argues that plaintiff is not entitled to equitable subrogation because it had actual or constructive knowledge of plaintiff's judgment lien. Some cases indicate equitable subrogation will be denied where the subrogee had actual knowledge of the junior lien prior to paying off the senior liens. (See, e.g., *Lawyers Title Ins. Corp. v. Feldsher* (1996) 42 Cal.App.4th 41, 53-54; *Darrough v. Herbert Kraft Co. Bank* (1899) 125 Cal. 272, 274.) Plaintiff's verified complaint asserted its assignor did not have knowledge of defendant's judgment or judgment lien at the time the new loan was made. Defendant presented no evidence to the contrary. Constructive knowledge is not sufficient grounds for denial of equitable subrogation. (*Smith, supra*, 175 Cal.App.3d at p. 1098; *Darrough, supra*, 125 Cal. at p. 275.)

Defendant also contends plaintiff was guilty of inexcusable neglect because it failed to discover plaintiff's judgment lien. The evidence presented indicates Jercich signed the deed of trust to plaintiff *before* defendant recorded his judgment, but the deed of trust was not recorded until after defendant's judgment. Thus, the loan was arranged before there was any constructive notice of defendant's interest in the property. In any event, failure to discover a recorded interest in the property does not of itself constitute inexcusable neglect. (*Smith, supra*, 175 Cal.App.3d at p. 1098.)

One of the prerequisites to equitable subrogation set out in *Caito* is that "'[s]ubrogation must not work any injustice to the rights of others.'" (*Caito, supra*, 20 Cal.3d at p. 704.) Defendant argues it would work an injustice to his rights if equitable subrogation is allowed in this case. He asserts plaintiff's loan was for a larger amount

than the preexisting loans, and giving its deeds of trust priority will put defendant in a worse position than if the refinancing had not taken place. The new lender is entitled to subrogation only to the extent of the prior encumbrance. (*Katsivalis, supra,* 70 Cal.App.3d at p. 215; *Smith, supra,* 175 Cal.3d at p. 1097.) If plaintiff is entitled to equitable subrogation, its deed of trust will be senior to defendant's judgment lien only to the extent of the prior liens. Defendant will be in exactly the same position as he was before the refinancing, so no injustice will result. Whether and to what extent plaintiff is entitled to equitable subrogation is an issue to be determined at trial, not in the ruling on plaintiff's request for a preliminary injunction.

We conclude that the trial court abused its discretion by denying plaintiff's request for a preliminary injunction based on its conclusion that plaintiff could not, as a matter of law, be equitably subrogated to the rights of the prior lien holder because it acted as a volunteer in refinancing Jercich's loans. The evidence before the trial court was sufficient to establish plaintiff's likelihood of prevailing on the merits at trial.

In determining whether to grant the request for a preliminary injunction, the trial court must consider both plaintiff's likelihood of prevailing on the merits and the balance of the harm to plaintiff if the injunction is denied and the harm to defendant if the injunction is issued. The trial court denied the injunction on the ground plaintiff could not prevail on the merits; it made no ruling and no findings on the balance of the harms. Consequently, we must remand the matter to the trial court to permit it to properly evaluate both factors and exercise its discretion in the first instance.

DISPOSITION

The order denying the preliminary injunction is reversed. The matter is remanded for further proceedings consistent with this opinion. Plaintiff is awarded its costs on appeal.

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HILL, J.

WE CONCUR:

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WISEMAN, Acting P.J.

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GOMES, J.